G, E-002/S-93-1065 ORDER APPROVING CAPITAL STRUCTURE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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| Don Storm | Chair |
| Tom Burton | Commissioner |
| Marshall Johnson | Commissioner |
| Cynthia A. Kitlinski | Commissioner |
| Dee Knaak | Commissioner |

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| In the Matter of the Petition of Northern States Power Company for Approval of its 1994 Estimated Capital Structure Prior to the Issuance of Securities for Calendar-Year 1994 | ISSUE DATE: January 26, 1994<br><br>DOCKET NO. G, E-002/S-93-1065<br><br>ORDER APPROVING CAPITAL STRUCTURE |

## PROCEDURAL HISTORY

On October 25, 1993, Northern States Power Company (NSP or the Company) filed its annual request for approval of its capital structure for calendar year 1994.

On December 7, 1993, the Minnesota Department of Public Service (the Department) filed its Report of Investigation and Recommendation in this matter. The Department recommended that the Commission approve the Company's petition.

On January 6, 1994, the Commission met to consider this matter.

## FINDINGS AND CONCLUSIONS

NSP's Proposal

NSP requested Commission approval of the Company's estimated 1994 capital structure and permission to issue securities. The Company requested approval of a best estimate 1994 capital structure based on its expectation to issue approximately $190 million of long term debt to fund the utility's construction program and reduce short-term debt levels. The Company also requested approval of a contingency amount with respect to each component and for total capitalization not to exceed $4,139 million with a $222 million cap on the contingency amount.

The Department's Comments

The Department stated that the estimated capital structure appears to be within the bounds of reasonableness with the proposed financing. However, the Department also expressed concern about the large contingency amounts requested by NSP for long-term debt and common equity. While recognizing NSP's need for flexibility, it noted that NSP's contingency issuances are not reflected in any capital structure contained in NSP's petition.

The Department believes NSP should provide additional information on the potential impact of its requested common-equity contingency. Specifically, NSP should identify the most likely significant deviations from its expected revenues, operating costs, and cost of capital, then show the impacts of the deviations on NSP's income statements, issuances of common equity and resulting capital structures.

With NSP's contingency issuances constrained by a total contingency limit of no more than $222 million, the Department did not believe its concerns about contingency issuances justify rejection of NSP's petition.

In sum, the Department recommended the Commission approve the Company's petition with the express requirement that its next capital-structure filing include contingency capital structures that reflect the most significant deviations from NSP's expected economic and financial environment as reflected in NSP's contingency requests.

Commission Concern

Deficiencies in the Company's proposal identified by the Department serve to underline the Commission's growing concern regarding its responsibility to provide regulatory oversight of utilities' capital structures. In this Order, the Commission will accept the Department's recommendation but will adopt measures which are aimed at improving the Commission's ability to execute its statutory oversight responsibilities in this area.

Minnesota law requires public utilities that are incorporated in the State of Minnesota or that encumber property in the state to obtain Commission approval of their capital structures prior to issuing securities. Minn. Stat. § 216B.49 (1992). The statute gives the Commission a great deal of discretion on how it approaches capital structure reviews. It sets out a number of elements the Commission must consider and approve, but does not specify a particular procedure for doing so.

Review of a utility's securities issuances and resulting capital structure is important for several reasons. The cost of capital is related to the utility's capital structure; as the proportion of debt increases, added financial risk can result in higher costs for both debt and equity capital which can create financial stress in times of low earnings. Excessive indebtedness can lead to in ability to met obligations and eventual bankruptcy. In theory, if a company is over-capitalized, it needs additional revenue to meet its fixed obligations and the Commission may be placed in the position of allowing the company to raise rates to meet its fixed obligations, or face financial stress. The financial stress could make it difficult for the utility to attract capital in the future. For these reasons, both excess debt and over-capitalization affect the rates and services of pubic utilities. Finally, there has been increased concern recently over utility diversification in non-utility ventures. Diversification has the potential to increase risk and cost of capital for utilities and could be reflected in rates. The capital structure review may provide an opportunity to study these kinds of utility activities and their potential impacts.

Commission Analysis

Consistent with current practice, NSP has presented a "best estimate" capital structure and requested that the Commission authorize it to make multiple issuances of stock for a one year period in amounts not to exceed its "best estimate" level *plus* a contingency amount in each capital component.[1] For example, the Company's "best estimate" for the amount of long-term debt it will issue in calendar-year 1994 is $190 million. In addition to its best estimated amount, the Company requests authorization to issue $310 million additional long-term debt during 1994 as a "contingency."

The Commission recognizes the practicality of authorizing some contingency amounts. Different capital structures will exist during the course of the year, depending on which securities have been issued at that point. In addition, it is impossible to be certain exactly what level of issuances will be needed during the year, due to uncertainties over interest rates, stock market conditions, construction plans, and other financing needs. Also, utility earnings cannot be predicted with accuracy.

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[1] The Company's best estimate of its issuances in calendar-year 1994 and the amounts it requests on a contingency basis are as follows:

| | Best Estimate | Contingency | Total |
|---|---|---|---|
| Long-Term Debt | $190 million | $310 million | $500 million |
| Short Term Debt | $224 million | $126 million | $350 million |
| Common Equity | None | $200 million | $200 million |
| Preferred Stock | None | $ 50 million | $ 50 million |

The utility's need for flexibility, however, must be balanced with the need for regulatory oversight by the Commission. The process of capital structure approval becomes essentially meaningless if too broad a range of contingencies for different classes of securities and/or total capitalization is allowed. In this case, the Commission finds that the Company's request fails to meet that balance.

<u>Commission Action</u>

Having considered the needs of the Company for flexibility and the need to establish more realistic Commission oversight, the Commission will approve the following contingency ranges:

> ***Equity ratio contingency range:*** the Commission will establish a contingency window (+ or - 10 percent) around the approved "best estimate" equity ratio of 47.74 percent. Equity ratios within that window (i.e. at or below 52.51 percent or at or above 42.97 percent) are approved. In addition, equity ratios that do not exceed 52.51 percent or fall below 42.97 percent for a period exceeding 60 days are also authorized. Those that fall outside the window for a period in excess of 60 days are not authorized by this Order. As soon as it becomes clear that a contemplated financial transaction would cause the Company's equity ratio to fall outside the window (i.e. exceed 52.51 percent or fall below 42.97 percent) for a period exceeding 60 days, the Company must seek Commission approval for this variation.
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> ***Total capitalization contingency range:*** rather than approve contingency amounts for each capital component as requested by the Company, the Commission will adopt the Company's suggestion at another part of its petition and place a cap on total capitalization at $222 million above the Company's "best estimate" total capitalization. Total capitalizations below the cap are approved. In addition, total capitalization that does not exceed the cap for more than 60 days are also approved. As soon as it becomes clear, however, that a contemplated financial transaction would cause the Company's total capitalization to exceed "best estimate" total capitalization by more than $222 million for a period in excess of 60 days, the Company will be required to seek approval from the Commission for that variation.

With the adoption of these reasonable parameters, the Commission has established both an appropriate range for Company discretion and clear triggers for further authorization proceedings before the Commission if that range would be exceeded.

In addition to these modifications to the Company's proposal, the Commission will clarify that the authorization granted in this Order shall run for a period of one year from the date of this Order.

## **ORDER**

1. The estimated capital structure submitted by Northern States Power Company (NSP or the Company) is approved. Contingencies with respect to the equity ratio and the total capitalization shall be as set forth in the body of this Order at page 4.

2. For a period of one year from the date of this Order, NSP is authorized to make one or more issuances of securities, provided that the impact of the issuance or issuances on the Company's capital structure is not to exceed the contingency ranges for equity ratio and total capitalization established in this Order for a period in excess of 60 days.

3. As soon as it has reason to know that a contemplated securities issuance would cause the equity ratio or the total capitalization to exceed the authorized limits for a period of more than 60 days, NSP shall seek approval for any such issuance.

4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)